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Re-evaluating the Effectiveness of the Intangible Rules under Section 197

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Notes and Comments

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INTRODUCTION

Before the enactment of the Omnibus Budget Reconciliation Act (OBRA) of 1993,[1] each intangible asset[2] was valued and amortized individually. There were many disagreements between the Internal Revenue Service (IRS) and taxpayers regarding valuations, appropriate useful lives and deductibility. In order to alleviate the backlog of cases in front of the Tax Court regarding these issues, Congress found the middle road. They passed Title XIII § 13261(a) of OBRA.[3] This section of the act made intangible assets meeting certain requirements amortizable over a fifteen-year life.[4] I intend to argue that this is patently unfair to taxpayers in a technological economy. The tax law met the goals of Congress, which included producing a predictable outcome on recovering the cost of intangible assets and reducing the number of cases in front of the courts on this issue. I intend to propose a method using the current tax code to achieve the same objectives, but to do so without causing taxpayers to wait fifteen years to amortize technology that will be obsolete in three to five years.

I will start out by analyzing the pre-enactment treatment of intangible assets. There are several types of intangible assets. They include goodwill, covenants not to compete, trademarks,

1. Pub. L. No. 103-66 Title XIII § 13261(a) 107 Stat. 312 (1993) (codified in scattered sections of 26 U.S.C.). The sections that are of concern to this topic are located in 26 U.S.C. § 197 and 26 U.S.C. § 167.

2. An intangible asset is an asset that is not a physical object, such as a patent, a trademark, or goodwill. Black's Law Dictionary 113 (7th ed. 1999).

3. Pub. L. No. 103-66 Title XIII § 13261(a) 107 Stat. 312 (1993).

4. *Id.* at 237.

workforce, computer software, franchises and licenses.[5] I will address some, but not all, of these. I will then analyze the post-enactment treatment utilizing the same intangible assets as discussed in the pre-enactment section. The goal is to highlight the similarities and differences in the methodology of taxation. I will then propose a method utilizing a structure similar to the modified accelerated cost recovery system (MACRS) used for depreciating tangible fixed assets. This method will allow for reduced debates regarding useful lives. I will argue that the new accounting rules issued by the Financial Accounting Standards Board (FASB) will allow for reduced disputes over valuations.

This comment recognizes that Congress has met their stated goals. However, it concludes by suggesting a different methodology that will meet the same objectives, but with less economic hardship to taxpayers.

BACKGROUND

Prior to 1993 tax act

Prior to OBRA of 1993,[6] each intangible asset had a different tax treatment. The tax treatment was dependent upon the type of intangible asset and the useful life.[7] Since the amortization deduction was calculated utilizing the value of the intangible asset and the useful life of the asset, these factors became critical to determining the appropriate taxable income. Amortization was on a straight-line basis, meaning the value of the intangible asset was generally divided by the number of years in the useful life of the asset.[8] This methodology generally stemmed from the matching principle. The Internal Revenue Code "endeavors to match expenses with the revenues of the taxable period to which they are properly attributable, thereby resulting in a more accurate calculation of net income for tax purposes."[9] Each factor (life and valua-

5. *See id.* at 212-24.

6. *Id.*

7. 26 C.F.R. § 1.167(a)-3.

8. Built in to the system of amortization is a pro-ration for any year that the asset was not owned for the entire twelve months of the taxable year. *See* 26 U.S.C. § 167. For example, assume a covenant not to compete was purchased for $100,000. If it were a four-year contract, the amortization expense would be $25,000 per year. The first and last year would be pro-rated if the contract was purchased on any date other than January 1.

9. Indopco Inc. v. Comm'r, 503 U.S. 79, 84 (1992).

tion) for each intangible asset had to be determined on an asset-by-asset basis.[10]

Intangible assets are created in three general types of transactions: self-created for a taxpayer's own use; purchase of individual assets; or the purchase and sale of a trade or business.[11] In prior law, the method of acquisition, in most cases, did not impact the life or the deductibility of the intangible asset. The value of the intangible asset was determined, in part, by the method of acquisition.[12] For self-created intangible assets, the value of the asset was the cost incurred in creating the asset.[13] Utilizing this method, there is no value that can be allocated to goodwill. Goodwill cannot be valued as it is created because the theory of goodwill was, and still is, that goodwill equals the excess of the fair market value of the business over the net assets owned.[14] Since goodwill reflects the excess value over the assets, there was generally no way to know how much goodwill was created with each dollar spent. The expenditures that generally helped to create goodwill included customer service, advertising and marketing.[15] These expenses were usually deducted as the costs were incurred under the

10. 26 U.S.C. § 1001(a) (1992), 26 U.S.C. § 167 (1993). The cost is determined based on the purchase price. *Id.* § 1001(a). The life is based on the determination of the limited useful life of the asset. *Id.* § 167.

11. *See id.* § 197 (1994).

12. *Id.* § 1012, § 1060, § 338, § 1031. If the asset was purchased in a tax-free exchange, then the value is determined by the value of the property given up. *Id.* § 1031. If the property is purchased in a taxable exchange the purchase price determines the cost. *Id.* § 1012. When a trade or business is purchased, the purchase price allocation rules must be utilized to determine the value of each individual asset. *Id.* § 1060, § 338.

13. *See* 26 U.S.C. § 1012 (1992).

14. Congress had not defined goodwill. The Courts have used various definitions. One such definition is by Justice Story defining goodwill as:

> The advantage or benefit, which is acquired by an establishment, beyond the mere value of the capital, stock, funds, or property employed therein, in consequence of the general public patronage and encouragement which it receives from constant or habitual customers, on account of its local position or common celebrity, or reputation for skill or affluence, or punctuality, or from other accidental circumstances or necessity or even from ancient partialities or prejudices.

Metropolitan Bank v. St. Louis Dispatch Co., 149 U.S. 436, 446 (1893) (quoting J. Story, Partnerships § 99 (1841)).

15. The definition of goodwill makes it difficult to identify exactly which expenditures create goodwill. However, since goodwill is generally related to repeat customers, the items that draw customers in are assumed to generate goodwill.

necessary and ordinary business expense rules.[16] One of the driving forces behind the expenditure was the current need to get the customers in the door in the first place. A secondary need was the development of repeat business.

A covenant not to compete, another example of an intangible asset, could have been created in a transaction between an employer and an employee: generally the contract is signed before the employee left the company (often the contract was signed at the time the employee was hired) and was effective after separation from the company.[17] This asset was generally amortizable over the life of the covenant; the value of the asset was determined by the contract between the employer and the employee.[18] The contract was not controlling in instances where the company and the employee were not acting with adverse tax interests.[19] In such a case, the courts had strictly scrutinized the transaction for accuracy in the valuation.[20] Even though the value of the contract was challenged, the life of the contract was generally respected.

Software that is self-created could have been deducted over sixty-months.[21] However, there were some exceptions to this. If the software had a useful life of less than one year, the cost of developing the software was deducted as an ordinary and necessary business expense.[22] Under specific circumstances, the expenses might have been deductible as research and development ex-

16. *See* 26 U.S.C. § 162 (1992).

17. *See* Beaver Bolt, Inc. v. Comm'r of Internal Revenue, 70 T.C.M. (CCH) 1364 (1995) (analyzing the value of a covenant not to compete between a former employee and employer).

18. *Id.*

19. *Id.*

20. *Id.*

21. *See* Rev. Proc. 69-21, 1969-2 C.B. 303. In 1993, 26 U.S.C. § 167(f) was codified as part of OBRA. This section allows software to be amortized over a thirty-six month period, as opposed to the five years required by the earlier revenue procedure. *See id.*

22. *See* 26 U.S.C. § 162 (1992). An example would be tax form software where each of the forms is good only for the tax year in question. Each year a new version of the software would be needed and therefore the cost of the software could be deducted in the year incurred. *See id.*

penses.[23] The incremental research credit may also be available for self-developed software.[24]

If assets were purchased independently from a trade or business, then the value of each asset purchased was determined by the fair market value.[25] Fair market value of the asset was determined by "the price at which property. . .chang[ed] hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having [had] reasonable knowledge of the facts."[26] As indicated earlier, there were certain assets that could not be purchased independently, such as goodwill and going concern value.[27] A covenant not to compete, other than between an employer and an employee, was generally entered into during the purchase and sale of a trade or business. It could not have been purchased independently, unless it was upon termination of employment.[28] Software that was purchased independently was amortized over a sixty-month period.[29]

There were several items to consider in a transaction regarding the purchase and sale of a trade or business.[30] The valuation method to be used for tax purposes was the residual method.[31]

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23. *Id.* § 174. This is a complex area of the law and is beyond the scope of this comment. For the purposes of this comment, I bring this to the attention of the reader, only so that the reader realize there is another area of which to be cognizant in making tax decisions related to software.

24. *Id.* § 41. *See* Norwest Corp. and Subs. v. Comm'r, 110 T.C. 454 (1998) (explaining the additional requirements for the research credit for internal use software). This area of the law is in a state of flux at the present time, mostly over the additional tests created for internal use software in the opinion.

25. *Id.* § 1001(b).

26. Willow Terrace Development Co., Inc. v. Comm'r, 345 F.2d 933, 936 (5th Cir. 1965).

27. *See* Red Wing Malting Co. v. Willcuts, 15 F.2d 626, 629-630 (8th Cir. 1926) (indicating that goodwill is not separable from the underlying business and it cannot be sold separately).

28. It is logical that someone will not purchase just a covenant not to compete. It would usually have no value outside the trade or business, or the employment, relationship.

29. *See* Rev. Proc. 69-21, 1969-2 C.B. 303.

30. This comment discusses only those items related to intangible assets purchased in a taxable transaction. There are many other considerations that need to be reviewed. These include: will this be stock for stock transaction, a cash for stock transaction, if a stock transaction, will an election be made under 26 U.S.C. § 338 to treat it as an asset acquisition. This list is definitely not exhaustive.

31. *See* 26 U.S.C. § 1060 (1992). Prior to codification of § 1060 taxpayers tried, somewhat unsuccessfully, to use the second tier allocation method. This method would generally cause less of the purchase price to be allocated to goodwill

This method required that the purchase price be allocated among the assets acquired.[32] The IRS created four classes of assets that the taxpayer utilized to allocate the purchase price.[33]

Class I included cash, demand deposits and liabilities assumed.[34] Class II included marketable securities and certificates of deposit.[35] Class III assets were those assets, including tangible and intangible assets that were not Class I, II or IV.[36] Class IV assets were goodwill and going concern value.[37] The residual method required, first, that the purchase price be allocated to Class I based on the value of the assets in the class.[38] After that first allocation the remaining purchase price was to be allocated to the remaining classes in sequential order.[39] Each class was allocated a portion of the purchase price based on its fair market value as of the date of purchase.[40] Each class had to be allocated the entire fair market value of that class before the next class was allocated any of the remaining unallocated purchase price.[41] If the purchase price could not cover all of the assets in the class, the amount was allocated to each individual asset in the class on the basis of its fair market value in relation to the total fair market value of that class.[42] Any remaining purchase price after the allocation to Classes I through III was allocated to Class IV, goodwill and going concern value.[43]

The intangible assets that were allocated to Class III had to meet certain requirements. The assets needed to be separately

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than the residual method. *See* Banc One Corp. v Comm'r, 84 T.C. 476 (1985) (residual method chosen over second tier allocation).

32. 26 U.S.C. § 1060 (1992).

33. *Id.* Note that the regulations increased the number of classes after the passage of OBRA of 1993.

34. 26 C.F.R. § 1.1060-1T(d)(1) (1992).

35. *Id.* § 1.1060-1T(d)(2)(i).

36. *Id.* § 1.1060-1T(d)(2)(ii).

37. *Id.* § 1.1060-1T(d)(2)(iii).

38. 26 C.F.R § 1.1060-1T(d)(2) (1992).

39. *Id.*

40. *Id.*

41. *Id.* § 1.1060-1T(d).

42. 26 C.F.R. § 1.1060-1T(d)(2) (1992). For example, assume 2 assets are in Class III. These are Asset A with FMV of ten and Asset B with FMV of five. Assume that the unallocated purchase price after Class I and Class II allocations is twelve. Asset A would have an allocated price of eight (10/(10+5)*12) and Asset B would have an allocated a price of four (5/(10+5)*12). Nothing would be allocated to Class IV (goodwill or going concern value).

43. *Id.* § 1.1060-1T(d)(2).

identifiable, valuable, and have a determinable useful life that can be reasonably estimated.[44] Any intangible assets that did not meet these requirements were considered part of the residual, meaning they were goodwill and/or going concern value.

Once the purchase price had been allocated to the assets that were purchased as part of the trade or business, a determination had to be made regarding the useful life and whether or not the asset was amortizable. "If an intangible asset [was] known. . .to be of use. . .for only a limited period, the length of which can be estimated with reasonable accuracy, [it] may be the subject of a depreciation allowance. . . ."[45] Shortly prior to OBRA of 1993,[46] the Supreme Court clarified that the intangible must be determinable separately from any goodwill.[47] Prior to the Supreme Court decision, there was a two-prong test to determine if an asset is goodwill or a separate intangible asset.[48] The two prongs were a separate and ascertainable value and a limited useful life, which can be determined with reasonable accuracy.[49] This test was an attempt at diminishing the controversies.[50] The court noted that cases revolve "on the precise nuances of its facts."[51] The burden is on the taxpayer to establish these facts.[52]

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44. *See* Newark Morning Ledger Co v. United States, 507 U.S. 546, 566 (1993) (holding that paid customer lists are separate from goodwill, even though it appears to reflect the expectancy of continued patronage. These lists were customers who had papers delivered to their specific addresses. They did not pay in advance and the relationship was terminable at will by either party. The IRS stipulated the valuation of the paid list and therefore the burden for Newark was much easier as they only had to prove that the list was separately identifiable with a determinable useful life than it would be under a different fact scenario.).

45. 26 C.F.R. § 1.167(a)-3 (1992).

46. Pub. L. 13-66 Title XIII § 13261(a) 107 Stat. 312 (1993).

47. *See Newark* at 566.

> A taxpayer able to prove that a particular asset can be valued and that it has a limited useful life may depreciate its value over its useful life regardless of the fact that its value is related to the expectancy of continued patronage. The significant question for purposes of depreciation is not whether the asset falls within the core concept of goodwill.

Id.

48. *See* Hous. Chronicle Pub. Co. v. United States, 481 F.2d 1240, 1250 (5th Cir. 1973).

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.*

Goodwill was defined as the continuous earning capacity and continued patronage of a business.[53] Going concern value was defined as the ability of the trade or business to continue as a profitable business after a merger or acquisition.[54] Even though the concepts were similar, they were different intangible assets. Neither goodwill nor going concern value was deductible prior to the 1993 act.[55]

During the purchase and sale of a business specific identification of intangible assets was a point of contention between taxpayers and the IRS.[56] The three main arguments concerned: value, life and deductibility of any amortization.[57] The main reason for the arguments was that taxpayers wanted to be able to deduct the cost of the intangible assets in the same manner that they could deduct the cost of the tangible assets purchased in the same transaction. Tangible assets purchased in these transactions were deductible over the IRS determined life.[58] For property placed in service after 1980, Congress modified the depreciation rules to eliminate discussions over the useful life and salvage value of tangible assets.[59] First, Congress introduced the Accelerated Cost Recovery System (ACRS), then for property placed in service after 1987, the system was changed to the Modified Accelerated Cost Recovery System (MACRS).[60] One idea of ACRS was to reduce the number of arguments between the taxpayers and the IRS over the depreciable life of tangible fixed assets.[61] One reason for the change to MACRS was to determine a life for a group of assets.[62] A

53. *See* Welch v. Comm'r, T.C.M. (RIA) 97,120 (quoting Wilmot Fleming Engineering Co v. Comm'r, 65 T.C. 847, 861 (1976)).

54. *Id.* (quoting Computing & Software Inc. v. Comm'r, 64 T.C. 223, 235 (1975)).

55. 26 C.F.R. § 1.167(a)-3 (1992).

56. *See* Staff of the Joint Comm. on Taxation, 103d Cong., *Technical Explanation of the Tax Simplification Act of 1993,* Title V Treatment of Intangibles (Comm. Print July 8, 1993) at 147-71.

57. *Id.*

58. *See* 26 U.S.C. § 168 (1992).

59. *See* Senate Rep. No. 97-144, 97th Cong., H.J. Res. 266 (stating the rules are too complex and result in unproductive controversies).

60. *See* Report of the Comm. on Finance, Senate Rep. No 99-313, 99th Cong., H.R. 3838 (indicating modifications were to make up for the loss of the investment credit).

61. *See* Senate Rep. No. 97-144, 97th Cong., H.J. Res. 266.

62. *See* Report of the Comm. on Finance, Senate Rep. No 99-313, 99th Cong., H.R. 3838.

table was created that employed the industry as well as the type of fixed asset to dictate the tax useful life of an asset.[63] Taxpayers then utilized that table to figure out the tax life and methodology of depreciating the tangible asset. The methodology was derived from the useful life of the asset.[64] Addressing the concerns for tangible assets was easier than for intangible assets because a taxpayer could touch and feel the tangible ones. A taxpayer could have looked at the asset and determined what it was, knowing the industry in which the taxpayer would use the asset. These two factors coupled with the MACRS tables as published enabled the majority of taxpayers to calculate the correct depreciation allowed.[65]

In the case of intangible assets it was more difficult for taxpayers to determine the value and the life of the asset.[66] Experts could have been hired to determine the value of the intangible assets acquired during the transaction. The definition of the intangible asset being valued was important, for example goodwill is not

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63. *See* 26 U.S.C. § 168 (1992). Publication 946 has an example of the table issued by the IRS for taxpayers to use in preparing their tax returns.

64. *Id.* (indicating that shorter lived assets are depreciated with a double declining methodology, mid lived assets are depreciated with 150% declining balance, and long lived assets are depreciated on a straight line basis).

65. MACRS is a depreciation method that allows taxpayers to recapture the cost of tangible fixed assets over their useful lives. The tables developed by Congress identify which life each asset falls into. The basic groupings are three, five, seven, ten, fifteen, twenty-seven and a half and thirty–nine year assets. Three, five and seven-year assets are depreciated over a 200% declining balance method. The ten and fifteen-year assets are depreciated using the 150% declining balance method. Twenty-seven and a half and thirty-nine year property are depreciated over a straight-line method. This is due in part to the fact that the assets in this group are real estate. Therefore the nature of the asset, and the life determine the methodology. The taxpayer looks up on one table the type of asset. That table will identify the life of the asset. Using that life the taxpayer then looks at the depreciation rate tables to see how much depreciation to take in the current year for that asset. For example, assume a computer cost 1,000. Looking up computers, a taxpayer would see that the life of a computer is five years. Then looking at the depreciation rate tables, the taxpayer would see that the rates for five year property are: year one = twenty percent, year two = thirty-two percent, year three = nineteen point two percent, year four = eleven point fifty-two percent, year five = eleven point fifty-two percent and year six = five point seventy-six percent. Each year a taxpayer would multiply the cost times the appropriate depreciation percentage to calculate the amount of depreciation deductible. (year one would be 200 (1,000 x 20%)).

66. *See Hous. Chronicle*, 481 F.2d at 1245-47 (listing various issues taxpayers have had with meeting the burden to prove the value and/or life of intangible assets).

deductible even if the parties do not call the intangible goodwill.[67] Prior to the 1993 tax act,[68] the Class III assets could have different lives for each transaction.[69] For example, computer software had a sixty-month amortization period, but a covenant not to compete had a life that varied depending on the duration of the contract. If multiple covenants were contracted, then each covenant could potentially have a different life. The taxpayer would generally argue for the shorter life, the IRS would argue for a longer life. The IRS could even argue, that although the taxpayer allocated the purchase price, they did not do so to the appropriate level of detail.[70] One goal of the IRS appeared to be to shift the value from the deductible items to non-deductible goodwill or going concern value. Depreciation or amortization deductions were taken over the life of the assets.[71] When assets were disposed, then gain or loss was calculated on the disposal.[72] The cost less the amortization taken to date was the adjusted tax basis of the assets for the calculation of the tax gain or loss.[73]

If the asset became worthless during the period of ownership, it was possible to abandon[74] the asset or take an obsolescence or worthlessness deduction.[75] These were "separate and distinct concepts;" therefore taxpayers could use either for deductions as long as all requirements were met for the chosen deduction.[76] The requirements for abandonment were that the taxpayer had the intent to abandon the asset and took an affirmative step to indicate

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67. *Id.* at 1247 (quoting Winn-Dixie Montgomery, Inc. v. United States, 444 F.2d 677, 681-82 (5th Cir. 1971)).

68. Pub. L. No. 103-66 Title XIII § 13261(a) 107 Stat. 312 (1993).

69. *See Hous. Chronicle* 481 F.2d at 1246 (suggesting that the burden is on the taxpayer to prove the duration of each intangible asset).

70. *See* Realty Loan Corp. v. Comm'r, 54 T.C. 1083 (1970) (holding that the allocation to a business should have been broken down further to goodwill and future income).

71. *See* 26 U.S.C. § 167 (1992).

72. *Id.* § 1012. Depending on various factors, the gain may be capital or ordinary. The capital gain may have special treatment.

73. *Id.* § 1016.

74. *Id.* § 165(a).

75. *See* 26 C.F.R. § 1.167(a)-8. These deductions are considered ordinary losses. The difference between capital gain and loss and ordinary income and loss is beyond the scope of this comment, but it is an item that tax professionals should take into consideration when assessing the options available.

76. Echols v. Comm'r, 950 F.2d 209, 211 (5th Cir. 1991).

such intent.[77] Prior to OBRA of 1993,[78] these deductions applied to purchased intangible assets.[79] However, goodwill was not subject to obsolescence even if purchased, because obsolescence was an expansion of the depreciation concept. Since goodwill was not depreciable, then obsolescence could not apply to it.[80]

Before taking any deduction, the taxpayer must satisfy the "all events test."[81] There were two prongs to this test.[82] The first was that "all the events have occurred which fix the right to receive such income."[83] For an actual disposal, this prong was generally easily met. If the taxpayer sold the item to a third party and the third party had control of the asset, then generally the first prong of the all events test was satisfied. The second prong was that the amount "can be determined with reasonable accuracy."[84] Again in a disposal, this is generally easy to calculate.[85] Therefore actual disposals of assets to third parties generally met the all events test and the gain or loss was a taxable event to the taxpayer when it took place.[86] It was more difficult to meet the requirements of this test for abandonment and worthlessness write-offs. For abandonment, the amount of what was being abandoned may have been difficult to determine. Where there was a complete abandonment of the intangible asset the test could be satisfied. The value in that case would be the adjusted tax basis at the time of abandonment.[87] For worthlessness or obsolescence, the issue was one of timing. It may have been difficult for a taxpayer to prove that the obsolescence took place in year X and not in year Y.[88]

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77. *See* Middleton v. Comm'r, 77 T.C. 310, 320 (1981).

78. Pub. L. No. 103-66 Title XIII § 13261(a) 107 Stat. 312 (1993).

79. *See* Appeal of Manhattan Brewing Co., 6 B.T.A. 952, 961 (1918) (holding self-created goodwill cannot get an obsolescence deduction).

80. *Id.*

81. *See* 26 C.F.R. § 1.446-1(c)(1)(ii) (1992).

82. *Id.*

83. *Id.*

84. *Id.*

85. The sales price less the adjusted tax basis is the gain or loss amount. When dealing with third parties in a straight disposal transaction, these numbers can generally be calculated with reasonable accuracy.

86. 26 U.S.C. § 1001(a) (1992).

87. *See* 26 U.S.C. § 1012 (1992).

88. It is possible that these requirements could have been met. The better the records, the better chance the taxpayer had of proving that the deduction meets the all events test. A thorough discussion of the all events test in the various transactions is beyond the scope of this comment. The burden is on the taxpayer to

The accounting rules during this period were diametrically opposed to the tax rules. Goodwill was amortizable over the life determined under the Financial Accounting Standards Board (FASB) rules.[89] The amount of expense for general accounting purposes each year was determined by the useful life calculated under generally accepted accounting principles (GAAP). If the goodwill became impaired before it was completely expensed through annual expensing, an impairment charge could have been recorded on the books, which allowed the company to write off the remainder of the unamortized balance for financial accounting purposes.[90]

Post 1993 tax act

In 1993 Congress passed OBRA.[91] The internal revenue code section 197 relating to intangible assets was part of the act.[92] Congress' stated purpose in passing this section is to reduce the number of cases in front of courts regarding the value and amortization of intangible assets.[93] Congress has used this methodology on other occasions in the past to reduce the number of cases where taxpayers and the government had regularly litigated the same types of fact-based disputes.[94]

This section governs the treatment of intangible assets.[95] Specific intangible assets are included in the definition of a section 197

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prove that all events have taken place in the year of deduction. *See* 26 C.F.R. 1.446-1 (1992).

89. *See* Financial Accounting Standards Board, Financial Accounting Series, Statement of Financial Accounting Standards No. 121 Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be disposed of ¶¶ 4-11 (1995).

90. *Id.*

91. Pub. L. No. 103-66 Title XIII § 13261(a) 107 State. 312 (1993) (codified in scattered sections of 26 U.S.C.). The sections that are of concern to this topic are located in 26 U.S.C. § 197 and 26 U.S.C. § 167.

92. 26 U.S.C. § 197 (1994).

93. *See* Staff of the Joint Comm. on Taxation, 103d Cong., *Technical Explanation of the Tax Simplification Act of 1993,* Title V Treatment of Intangibles (Comm. Print July 8, 1993) at 147-71.

94. H.R. Conf. Rep. 99-841 pt. III, at 310-14 (1986) (stating "the conferees are aware that treatment of independent research and development is presently a subject of controversy"), S. Rep. 96-1036 (1980) at 11 (indicating the goal of the bill is to "to decrease controversy and litigation arising under present law"), H.R. Rep. 105-817 at 62 (1998) (defining what qualifies as specified loss liability to reduce controversies).

95. 26 U.S.C. § 197 (1994).

intangible.[96] There are also some specific items excluded.[97] Once an intangible asset is included in the definition of section 197, the asset is amortized over a fifteen-year period.[98] Amortization begins on the first day of the month that the intangible is acquired.[99]

Since the enactment of the new section, most self-created assets are treated identically as they were before the enactment of section 197, as specific self-created assets are excluded from the definition of a section 197 intangible.[100] For example, goodwill is not amortizable as a section 197 intangible when self-created; however many of the expenses incurred to create the goodwill may be deductible as ordinary and necessary business expenses, just as they were before the act.[101] A covenant not to compete that is between an employer and an employee is not "entered into connection with an acquisition. . .of an interest in a trade or business."[102] Therefore the covenant will be amortized over the life of the covenant.[103] Computer software under section 197 has special rules.[104] If software is self-created, purchased independently, or readily available for purchase by the general public, subject to a non-exclusive license, and has not been substantially modified then it falls outside of the definition of a section 197 intangible.[105]

The assets that are purchased independent of a trade or business have varied treatment. Some intangible assets are included in the definition of a section 197 intangible, subject to fifteen-year amortization; some are excluded from the definition.[106] Again, if

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96. *Id.* § 197(d).
97. *Id.* § 197(e).
98. *Id.* § 197(a).
99. *See* 26 C.F.R. § 1.197-1T (1994).
100. 26 U.S.C. § 197(c)(2) (1994).
101. *Id.* § 162 (1992). See the discussion *infra* Part IIA to see examples of expenses that may create goodwill.
102. *Id.* § 197(d)(1)(E) (1994).
103. As the covenant does not meet the definition of a section 197 intangible, then section 197 does not apply to it. Once an asset is determined not to fall into 26 U.S.C. § 197, other rules apply. Therefore section 167 would apply which looks at the useful life of the underlying asset. 26 U.S.C. § 167 (2001).
104. *Id.* § 197(e)(3) (1994).
105. *Id.*
106. This requires that the taxpayer take special care in reading and understanding the definition of a section 197 intangible asset because it is easy to run afoul of the depreciation rules. This is important because the depreciation that is needed for the gain or loss calculation is depreciation or amortization that is allowed or allowable. *See* 26 U.S.C. § 1016 (1992). If the wrong amortization is taken and the tax year closes, when the assets are later sold, the taxpayer can

the asset is included in the definition, fifteen-year amortization is applicable.[107] If it is not included, then prior rules apply.[108]

Almost all intangible assets that are purchased as part of a trade or business fall under the definition of a section 197 intangible. The section specifically includes goodwill and going concern value.[109] As such, goodwill and going concern are now amortizable over a fifteen-year period, just like any other section 197 intangible.[110]

The purchase price allocation rules under section 1060 of the internal revenue code still apply in the same manner as prior to OBRA of 1993.[111] This section has recently been updated to include cross-references to section 197.[112] The changes to section 1060 include expanding the number of classifications to seven.[113] This expansion helps give the IRS more information regarding the valuation of the assets purchased;[114] it also effects the allocations to specific groups of assets where the purchase price is less than the fair market value of all of the assets purchased.[115] The methodology of this section has not been changed by the passage of section 197, only the specifics regarding which assets fall into each class have changed.[116]

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possibly permanently lose a deduction for tax amortization that should have been taken in a closed year.

107. *See* 26 U.S.C. § 197 (1994).

108. *Id.* § 167.

109. *Id.* § 197(d)(1)(A)-(B) (1994).

110. *Id.* § 197(a) (1994).

111. Pub. L. 13-66 Title XIII § 13261(a) 107 Stat. 312 (1993).

112. *See* 26 C.F.R. § 1.1060-1 (amended Feb. 13, 2001).

113. *Id.* § 1.1060-1

114. One of the new classes created is Class VI. This class is for all section 197 Intangible assets other than goodwill and going concern value. *See* 26 C.F.R. § 1.338-6 (2001). The IRS will now have information at a glance regarding what was purchased for each transaction in which a Form 8594 is required to be filed.

115. Assume a taxpayer has the following assets. Also assume, that due to other business reasons, the assets are not being sold at fair market value, but are being sold at the seller's basis in the property. This is called a bargain purchase. *See* Table 1.

The overall purchase price has not changed. However in the bargain purchase realm, the price allocated to the current assets is higher under the new regulations. This is beneficial to the taxpayer as equipment is a capital asset and will take longer to recover for tax purposes than the current assets.

116. The major difference upon a reading of each code section is the number of classes. However, 26 U.S.C. § 1060 (2001) does state that the Class information can now be found in 26 C.F.R. § 1.338-6 (2001).

Once the value of the individual intangible assets has been determined, it is amortized over the fifteen-year period demanded by Congress.[117] If any one of these intangible assets is disposed of, any loss realized cannot be deducted until all intangible assets purchased in the same transaction, or series of transactions, are disposed of.[118] This means that when a trade or business is purchased, and the purchaser has decided to sell off a portion of that business, the investment is tied up for the remainder of the fifteen-year period from the date of purchase.[119] Abandonment and worthlessness deductions are still a part of the internal revenue code and apply to purchased intangible assets as well as most tangible fixed assets.[120] However, the code specifically states that the term "disposed" includes abandonment.[121] Therefore it is impossible to get any sort of deduction for purchased intangible assets when purchased as part of a trade or business, when any of the intangible assets purchased together are still owned by the taxpayer, for a period of up to fifteen years.[122] Taxpayers will not have to allocate any of the loss on any disposals of other intangible assets purchased in the same transaction or series of transactions to any intangible that the taxpayer has abandoned, or they can prove worthlessness or obsolescence.[123] In fact, the net tax value of such abandoned or obsolete intangible assets should be allocated to the remaining intangible assets in the same manner, as a loss on disposal.[124] The one exception to this is covenants not to compete.[125] These assets shall not be deemed to be worthless, abandoned or disposed unless the entire interest of the trade or business that was purchased with the covenant not to compete is disposed.[126]

Note that the all events test is still part of the Internal Revenue Code.[127] A third prong is added to the requirements of the

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117. 26 U.S.C. § 197(a) (1994).
118. 26 C.F.R. § 1.197-2(g)(1) (2001).
119. *Id.*
120. 26 U.S.C. § 165(a) (2000); 26 C.F.R. § 1.167-8(a) (2000)
121. 26 C.F.R. § 1.197-2(g)(1) (2001).
122. *Id.* (distinguishing between intangible assets purchased as part of a trade or business and those purchased independently).
123. *See* 26 C.F.R. § 1.197-2(g)(1) (2001).
124. *Id.*
125. 26 U.S.C. § 197(f)(1)(B) (1994).
126. *Id.*
127. *Id.* § 1.446-1(c)(1)(ii) (2000).

test. It requires that "economic performance. . .occu[r] with respect to the liability."[128] "Except as otherwise provided in [the Internal Revenue Code], if the liability of a taxpayer arises out of the providing of services or property to the taxpayer by another person, economic performance occurs as the services or property is provided."[129] Again for disposals, this is an easy test to meet. Abandonment and worthlessness deductions would have the same issues associated with them as they did prior to the change in the law.[130]

When the intangible assets are disposed, a gain or loss is calculated.[131] The loss disallowance section only disallows the loss.[132] Therefore any gain that is realized on the transaction must be recognized for tax purposes as the transaction occurs.[133]

ANALYSIS

Once Congress changed the treatment for intangible assets, it appears that the number of court cases was reduced.[134] Some scholars believed that this was a good treatment of intangible assets.[135]

I take a contrary view. In this economy where a large number of software, or "dot com", companies are being purchased mainly for software, the purchasing taxpayer is potentially ending up in a

128. *Id.*

129. *Id.* § 1.461-4(d)(2) (2001).

130. A thorough discussion of economic performance is beyond the scope of this comment. The point is that when an item is sold to a third party in a corporate context, it is very, very rare that the tax law would completely prohibit the recognition of that loss. It may be deferred until there is a gain to use the loss against (as in the capital loss recognition rules). 26 U.S.C. §§ 1211-1212 (2001).

131. This is the same calculation as discussed *supra* notes 71-2 and accompanying text.

132. *See* 26 C.F.R. § 1.197-2(g)(1) (2001).

133. *See* M. Charles Collins, Note, *New Section 197 of the Internal Revenue Code: Simplifying the Amortization of Intangibles in the Wake of Newark Morning Ledger Co. v. United States*, 25 U. Tol. L. Rev. 815, 842 (1994) (stating that Congress may have been trying to recover revenue lost due to excluding certain kinds of software from the application of section 197).

134. A search based on section 197 and intangible assets only yielded a handful of cases, while a search before 1993 based on goodwill yielded hundreds of hits.

135. *See* Gregory M. Beil, Comment, *Internal Revenue Code Section 197: A Cure for the Controversy Over the Amortization of Acquired Intangible Assets,* 49 U. Miami L. Rev. 731 (1995) (concluding "Section 197 will substantially eliminate disputes between taxpayers and the IRS with respect to allocation of purchase price and useful life").

costly tax situation. This is true especially in the New England area where technology is one of the leading industries.[136]

It is virtually indisputable that being able to deduct goodwill is beneficial for taxpayers. There is also a benefit to knowing that the valuation placed on intangible assets, although important, will not be challenged as ferociously because the impact on the deductibility is limited due to the standardization of amortization.

However, due to the elongated amortizable lives and the loss disallowance rules, the change in the tax law has some detrimental effects to the taxpayer that have not previously been analyzed.[137] Prior to the act, when a taxpayer purchased a company, the purchase price was allocated to each asset and each intangible was amortized over their individual useful life. For example, software was written off over a thirty-six month period. If the taxpayer could prove that the asset was disposed of, abandoned or worthless an immediate write-off was allowed. Therefore, intangible assets and tangible assets were treated the same. If the taxpayer continued to use a portion of the software for the next generation of software it is more likely that the taxpayer would be willing to continue amortizing the software over the tax life, as it was only a delay of up to three years.

Under the new code section, the intangible assets are still allocated a portion of the overall purchase price.[138] All intangible assets that fit within the definition of a section 197 intangible are then amortized over a fifteen-year period.[139] Even if the taxpayer can prove that the asset was disposed, abandoned, or worthless, the deduction cannot be recognized by the taxpayer. The taxpayer

136. *See* Massachusetts Division of Employment and Training Manual (1998) (demonstrating that between 1993 and 1998 13% of all jobs created in MA were high tech jobs. The computer software industry accounted for 76% of these jobs. The pamphlet also indicates that high tech was the biggest industry in 1998 for MA. A chart included shows a similar trend for the Northeast.).

137. In the discussion of section 197 to this point, the focus has been on the goodwill. However, the loss disallowance rules have not been mentioned. In at least one article software has been treated as if it had been exempted from these rules. Catherine L. Hammond, Comment, *The Amortization of Intangible Assets: Section 197 of the Internal Revenue Code Settles the confusion* 27 Conn. L. Rev. 914, 915 (Spring 1995) (stating "excluded assets are . . . computer software . . .). However purchased software that has not been exempted is still subject to these rules. 26 U.S.C. § 197(d)(1)(C)(ii) (1994).

138. 26 U.S.C. 1060 (2001), 26 C.F.R. 1.338-6 (2001).

139. 26 U.S.C. 197(a) (1994).

must allocate the loss to the other intangible assets that are purchased in the same transaction or series of transactions; covenants not to compete cannot be allocated in this manner.[140]

Congress could have achieved the results they were looking for by utilizing already existing code sections. One alternative that they could use is the same methodology employed for tangible fixed assets.[141] Create a table indicating what life each intangible asset would have based on the type of intangible and the industry in which the asset is used.[142] Congress could then allow taxpayers to use the disposal, abandonment and worthlessness rules that apply to the tangible fixed assets. This methodology would allow consistency among the tax laws for all types of capitalized fixed assets.

The biggest issue arising under this methodology is that the valuation methods would again be debatable. This could possibly mean increased taxpayer and IRS controversy. However, there is a new development at this time that will allow these controversies to be minimized.

The FASB has developed new rules for the treatment of goodwill and intangible assets purchased as part of a trade or business. The new FASB rules no longer allow for goodwill or going concern value to be amortized.[143] As such, the accounting rules and the tax rules have now been completely transposed.

The accounting rules also state that if there is a separately identifiable asset that can be sold, then that asset has to be valued separately from goodwill.[144] Those assets are amortizable over the life of the intangible asset for book purposes.[145] We should take it as a given that the accounting life of the intangible may very well be different from the tax life ascribed to the same intangible asset.

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140. *Id.* § 197(f)(1)(B).

141. 26 U.S.C. § 168 (2001).

142. For example, software could be amortized over thirty-six months, while covenants not to compete can be governed by the contract and goodwill could remain at fifteen years.

143. *See* Financial Accounting Standards Board, Financial Accounting Series, Statement of Financial Accounting Standards No. 142 Goodwill and Other Intangible Assets (2001).

144. *See* Financial Accounting Standards Board, Financial Accounting Series, Statement of Financial Accounting Standards No. 141 Business Combinations ¶ 39 (2001).

145. FAS No. 142 ¶¶ 10-14 (2001). For purposes of this comment, I am addressing only taxable purchases of corporations. Therefore, the separately identified assets listed in FAS No. 141 will be amortizable for tax purposes as well.

The financial rules try to clearly reflect the financial condition of the corporation for Securities and Exchange Commission reporting.[146] The tax rules are looking to reflect economic reality.[147] However, the tax rules are often implemented for policy reasons such as to spur investment or to reduce controversies between taxpayers and the IRS. These competing goals can, and often do, cause the useful lives of capital assets to be different for each set of calculations. This should have no impact on the reasonableness of this discussion, because the accounting lives for most assets, including tangible fixed assets, are different from the tax lives.

Congress can leverage off the new accounting rules because it is now necessary for the purchase transactions to be valued at fair market and have the price allocated for financial accounting and Securities and Exchange Commission (SEC) reporting.[148] Any remainder will be allocated to goodwill.[149] These rules are very similar to the allocation of purchase price under the tax rules.[150] If Congress accepts the accounting rules as appropriate, the arguments regarding valuation can be diminished. Public companies registered with the SEC must have their annual financial statements audited by independent public accountants.[151] In order for auditors to express an opinion on the financial statements they must test the books and records during the audit.[152] The audits are performed in accordance with generally accepted auditing standards (GAAS), to verify that the accounting records are in compliance with GAAP.[153] This testing and inspection mandates documentation for any valuation of the allocations made.[154] The tension between the financial accountants and the tax specialists

146. This is demonstrated by the use of the unqualified audit opinion. Independent auditors when completing an audit can express their opinion in many ways. The desired opinion is an unqualified opinion which states that "the financial statements . . . present fairly, in all material respects, in the financial position of . . . ." 10-K Oracle Corporation 2001.

147. *See Indopco*, 503 U.S. at 79 (explaining the matching principle).

148. FAS 141 ¶¶ 35-46.

149. *Id.* ¶ 43.

150. *See* 26 U.S.C. § 1060 (2001).

151. *See* 15 U.S.C. § 77aa(25)-(26).

152. An audit is defined as the systematic inspection of accounting records involving analysis, tests and confirmations. Black's Law Dictionary 126 (7th ed. 1999).

153. Black's Law Dictionary 226 (7th ed. 1999).

154. The auditors review the audit trail to verify that the books are in compliance with GAAP. The audit trail is the documentation that links the original ac-

will allow for reasonableness in the valuation. The tension will be created because the financial accountants will want the purchase price to be allocated to goodwill.[155] Goodwill can no longer be expensed for book purposes,[156] and therefore cannot affect earnings per share, a primary concern for corporate accountants. The tax specialists would prefer to have less allocated to goodwill, which would have a fifteen year life, and more allocated to software, or covenants not to compete, etc, to be able to get a faster deduction for tax purposes. This tension will benefit the IRS because each group will try to support its position. In theory, the best supportable number will be utilized.[157]

Once these allocations are made pursuant to the accounting rules, I propose that Congress use a table developed similarly to the modified accelerated cost recovery tables. Since Congress has already decided that thirty-six months would be an appropriate useful life for computer software, that life can be used for amortization purposes. The table can indicate by industry the proper life for each type of intangible asset.

Using this method a taxpayer can use one allocation of purchase price and not have different cost basis for tax and for book purposes. While different lives for book and tax is common for assets, the cost basis is generally the same.[158] While there are times that items that are not capitalizable for accounting purposes will be capitalizable for tax purposes,[159] the cost is often the same.

This method will allow for consistency in the disposal, abandonment and worthlessness rules. The documentation needed

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counts to the presentation in the financial statements. Black's Law Dictionary 226 (7th ed. 1999).

155. This tension can be likened to the requirements that parties to the transaction must have adverse tax interests for allocations. *See Beaver Bolt*, 70 T.C.M. at 1364.

156. FAS 142 ¶ 18 (2001).

157. The ultimate agreement by the external auditors for GAAP and SEC reporting strongly supports the theory. Currently there is much in the newspapers about Arthur Andersen LLP and their role in the collapse of Enron. The backlash of this event can have several side effects. One of these side effects, already taking place, is increased testing by independent auditors with the hopes of overcoming the lack of trust of the investing public.

158. Since the cost is determined by the purchase price, it is very difficult to get a different cost basis. The difference mainly arises when an item is expensed for book purposes, but capitalized for tax purposes. The expenditure for the item still has not changed.

159. *See Indopco*, 503 U.S. at 79; 26 U.S.C. § 195 (2000); 26 U.S.C. § 248 (2000).

would also allow taxpayers to generally be in a position to support the cost basis. After all, the accounting rules require allocation based on fair market value. Taxpayers would be able to get a deduction over a reasonable life for assets. For example, computer software would be deducted over a thirty-six month life as opposed to a fifteen-year life.[160]

If during this transaction or series of transactions, the taxpayers found that software did not fit with the overall purpose of the purchase and decided to sell the software while they were consolidating their core competencies, they would be allowed the benefit of the tax deduction when the event took place.

In this downturn of the economy, many businesses are downsizing while concentrating on their core competencies. Many of these same businesses in the last several years have been buying smaller companies for specific assets, tangible and/or intangible. Many companies, for financial accounting purposes, are taking restructure or special charges and are writing off many of the assets they have purchased in these types of transactions. However, for tax purposes, since they are possibly retaining at least one intangible related to the asset, then no current tax benefit will be allowed.[161]

Under the current rules, the individual or small number of intangible assets being retained will have the remaining unamortized cost allocated directly to it. For example: Assume a taxpayer purchased a "dot com" company for $3,000,000. As a "dot com" company, the tangible fixed assets are usually minimal, assume a value of $10,000. Imagine a workforce worth approximately $50,000, non-compete agreements valued at $500,000, trademarks worth $100,000, computer software with a value of approximately $1,000,000. The remainder of the purchase price – $1,340,000 – would be allocated to goodwill. Assume that the taxpayer could prove that the workforce was laid off. Assume the non-compete covenants are worthless because the people who signed the agreements have decided to retire from the industry and become the greeter at the local Wal-Mart store. Assume that the software is currently being sold at a loss to an unrelated third party. Assume

160. Very little software, if any, is not obsolete after three years.

161. A deferred income tax benefit may be allowed. These rules, Financial Accounting Standards Board Series, Financial Accounting Standard No. 109 Accounting for Income Taxes, are beyond the scope of this comment.

the loss on disposal would be deductible but for the section 197 loss disallowance rules. Assume, that the trademark has been abandoned and the business has continued, but under the stronger mark of the purchasing corporation. In this case, the covenant not to compete and goodwill would be allocated the remaining unamortized value of the worthless, disposed or abandoned assets. Assuming that these transactions occur seven years from the date of purchase, the value of the covenants would be $433,336 and the value of the goodwill would be $1,161,333.[162] The value of the covenant not to compete actually exceeds the fair market value of the same covenant at the time of the purchase. This is apparently the intended result of Congress, demonstrated by the intentional language that covenants not to compete shall not be disposed, abandoned or deemed worthless.[163] This is a very harsh result that contradicts the underlying premise of the purchase price allocation rules under section 1060 requiring the purchase price to be allocated to an asset, but not in excess of its fair market value on the date of purchase.[164] While it is possible for the market value of assets to increase over time, our tax code is based on historical cost. The cost is determined at the time of acquisition.[165] Cost is then adjusted upwards for additional expenditures that increase the life of the asset, or downwards for depreciation and/or amortization.[166] If Congress wants taxpayers to adjust the cost to fair market value, separate legislation should be passed.[167] Since Congress has not passed this legislation, the historical cost rules should apply. However, they are being bypassed by function of the loss disallowance rules in section 197.

It appears that Congress, in wanting to eliminate the number of controversies between the IRS and taxpayers, has managed to undercut the other tax rules that interact with the amortization

162. Ntv is the net tax value of the asset. This is calculated as cost less amortization allowed for tax purposes. *See* Table 2.

163. 26 U.S.C. § 197(f)(1)(B) (1994).

164. *See* 26 U.S.C. § 1060 (2001).

165. *See* 26 U.S.C. § 1012 (2000).

166. *Id.* § 1016.

167. An example of this is the mark to market rules for certain investments. In these transactions, each year taxpayers must recognize gain or loss based on the fair market value of the asset as of the last day of the tax year. This is to be calculated even if the taxpayer did not dispose of the asset. It is very rare that this type of calculation will be mandated. Congress, to date, has not passed legislation that will cause this calculation for intangible assets.

rules, leaving taxpayers in a difficult tax position in a worsening economy. Allowing the loss on disposal to be taken in the year of the economic loss would free-up resources of the taxpayer to utilize in other areas of its business enterprise.

CONCLUSION

The pre section 197 law was difficult to administer because each determination of useful life, value and amortization had to be determined on a case-by-case basis. This caused many arguments between taxpayers and the IRS. To help solve this problem, Congress enacted 26 U.S.C. § 197. This internal revenue code section modified the treatment of intangible assets. While applying to several types of intangible assets, the biggest changes related to the intangible assets acquired during the purchase and sale of a trade or business.

In this instance, all intangible assets were now to be amortized over a fifteen-year period starting with the first day of the month the intangible was acquired. This change allowed goodwill and going concern value to be amortized and deducted. Until this point no amortization for either was allowed as a deduction for tax purposes. The best the taxpayer could hope for in relation to the purchased goodwill or going concern was a capital loss on disposal. While taxpayers saw the change in the goodwill as a beneficial change, the extension of the tax lives of some of the other intangible assets was detrimental to many taxpayers.

Software, which had a relatively short amortizable life, five years, and covenants not to compete which had a life that was usually governed by the contract, were both extended to a fifteen-year amortization period. This would be more acceptable if the regulations stopped there. However, Congress added an additional wrinkle. They included a loss disallowance rule. Therefore, even if the taxpayer sold, abandoned, or proved obsolescence of the intangible, no loss is allowed unless *all* intangible assets purchased in the same transaction or series of transactions were also sold, abandoned or proved obsolete. In the case of covenants not to compete, the law is even harsher: no loss is allowed unless the entire interest in the trade or business that was purchased in the same transaction is disposed of. This section of the law makes the law egregiously unfair to business taxpayers.

I have provided an alternative. Congress can create tables, similar to those used in MACRS, to calculate a tax life for intangible assets. The tables should be based on the type of intangible and the industry the intangible is to be used in. This would meet Congress' goal of limiting controversies between taxpayers and the IRS because the tables would be established as law. Taxpayers would not be able to utilize any life they may choose, but must use the life mandated by the tables. The types of intangibles used in the tables would closely correlate with the new FASB accounting rules. Taxpayers would be able to use shortened lives for some intangible assets, and longer lives for others such as goodwill and going concern.

This leads to the question of how would one allocate purchase price among the various assets. Recent changes in accounting rules already provide a workable answer to that same question. In the most recent FASB rules, that went into effect for purchases of companies after July 31, 2001, goodwill and going concern value are no longer amortizable. However, intangible assets that have a determinable useful life and that are identifiable as separate from goodwill can be amortized and must be stated separately from any goodwill or going concern value. This means that corporations that are subject to GAAP must have valuations of intangible assets upon purchase of a trade or business. These valuations can be prepared in house, or by external experts. However, the valuations must be supportable enough to provide the external auditors the ability to determine the accuracy of the valuations.

Using the valuations needed for GAAP reporting, and the tax lives mandated by Congress, the controversies between taxpayers and the IRS will be minimized. Taxpayers will be allowed to use a more appropriate life (i.e., not have to amortize software that is obsolete in three years over a fifteen year life). Taxpayers will also be allowed to match the loss on disposal with the actual economic event of disposing the asset.

This is a better application of core underlying tax concepts such as the matching principle and the all-events test. In a downturn of the economy, the tax savings may allow taxpayers to invest in replacement assets that they may have to postpone under the current tax law.

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TABLE 1

Asset	Basis	FMV
Cash	1,000	1,000
Land & Equipment	2,500	3,000
Accounts Receivable	200	200
Inventory	300	350
Goodwill		450
Totals	4,000	5,000
Allocations:		
	Pre-OBRA	Post-OBRA
Class I	1,000	1,000
Class II	3,000	
Class III (Accounts Receivable)		200
Class IV (Inventory)		350
Class V (Land & Equipment)		2,450
Total purchase price	4,000	4,000
Allocation within Class II		
Land & Equipment	2,535	
Accounts Receivable	169	
Inventory	296	
Total Class II	3,000	

TABLE 2

	Cost Allocation	Amortization per year	Amortization for 7 years	Ntv	Loss	Reallocated	Adjusted ntv
Price	3,000,000						
Fixed assets	10,000						
Workforce	50,000	3,333	23,331	26,669	(26,669)		—
Covenant	500,000	33,333	233,331	266,669		166,667	433,336
Trademarks	100,000	6,667	46,669	53,331	(53,331)		—
Software	1,000,000	66,667	466,669	533,331	(533,331)		—
Goodwill	1,340,000	89,333	625,331	714,669		446,664	1,161,333
Totals	3,000,000	199,333	1,395,331	1,594,669	(613,331)	613,331	1,594,669